



**Grobstein, Horwath & Company LLP**

Certified Public Accountants  
Member Horwath International

15233 Ventura Boulevard, Ninth Floor  
Sherman Oaks, California 91403-2201  
818.501.5200 Main  
818.501.7040 Fax

**Via email - Robert E. Shannon and J. Charles Parkin**

July 23, 2008

Robert E. Shannon, Esq., City Attorney  
J. Charles Parkin, Esq., Principal Deputy City Attorney  
Office of the Long Beach City Attorney  
333 W. Ocean Blvd., 11th Floor  
Long Beach, California 90802

**Re: QSDI & RMS Transaction Analysis Summary**

Dear Mr. Shannon and Mr. Parkin:

This letter summarizes the analysis of Grobstein Horwath & Company LLP ("GHC") as of March 21, 2008 to identify transfers made by Queen's Seaport Development, Inc. ("QSDI") or by RMS Foundation, Inc. ("RMS") to or on behalf of various individuals or entities. Such transfers may be recoverable by QSDI or RMS using various legal theories. Our investigation and conclusions are limited by the records made available for our review and the constraints of time in which we had to conduct the review. Therefore, additional investigation and discovery may be needed for the transactions identified.

Below, an Executive Summary is provided briefly describing our methodology and findings. Additional detail regarding the items highlighted in the Executive Summary follows in the section entitled "Summary of Detailed GHC Analyses."

**EXECUTIVE SUMMARY**

**Methodology**

Our investigation to identify transfers that may be recoverable by QSDI or by RMS can be divided into two general analyses:

- **Analysis of General Fund cash receipts and disbursements.** We analyzed the cash receipts and disbursements from the General Funds cash account activity of both entities.
- **Analysis of general ledger detail.** We searched the detailed transactions listed in the general ledgers of both entities to identify other transactions with select individuals and entities that were not previously identified from our analysis of the general funds cash account transactions. The select individuals and entities included Howard Bell ("Bell"), Joseph Prevratil ("Prevratil") and Leisure Horizons Inc. ("LHI"), an entity owned by Prevratil.

Our work identified various payments made by QSDI and RMS directly to or on behalf of Bell, Prevratil and LHI that may be recoverable. We summarized the identified transactions and compiled available supporting documentation, including cancelled checks, invoices, email, memorandum and other documentation.

### **Findings**

From the available books and records, GHC identified and reviewed transfers from QSDI and RMS to or for the benefit of Prevratil/LHI and Bell totaling more than \$7.9 million and \$4.1 million, respectively. We identified potential causes of action or items that might be recoverable from Prevratil/LHI and Bell as follows:

- **Condo in Hawaii.** GHC identified QSDI payments totaling \$209,147.70 made for the benefit of Bell and Prevratil whereby QSDI funds were used for the purchase and on-going use of a condominium in Hawaii. The transactions were specifically recorded, at Bell's direction, as ordinary business expenses and not recorded as personal transactions of Bell and Prevratil. GHC did not locate any evidence that such transactions were reported as taxable compensation to Bell and Prevratil. The payments were partially offset by \$57,814.31 of accounting entries that may represent rental income received from Waikiki Shore Resort. The condo, believed to be worth more than \$1,000,000, should be recoverable from Bell and Prevratil.
- **Transfers from QSDI to LHI/Prevratil re: Alleged Loans.** LHI/Prevratil claim that they lent to or paid on the behalf of QSDI \$1,096,000 and that they were repaid \$1,047,000. GHC analyzed the transactions between LHI/Prevratil and QSDI and determined that some of the payments made by QSDI may be "preferences." As defined by the Bankruptcy Code, "preferences" are payments that meet specific criteria and in very general terms represents a payment made to one creditor (in this case an "insider" – LHI/Prevratil) in preference to other QSDI creditors such that the creditor receiving the payment received more than other creditors would receive in a liquidation of QSDI. GHC believes that \$387,000 of the payments made by QSDI may be recoverable from LHI/Prevratil as preferential payments. Under certain circumstances, if additional discovery proves actual or constructive fraud relative to the transfers, the entire \$1,047,000 may be recoverable.
- **Reimbursements Claimed by Prevratil.** GHC located evidence that QSDI and RMS made payments to Prevratil or LHI totaling \$108,500.49 for claimed "expense reimbursements." Ostensibly, such payments were reimbursements for business expenses of QSDI paid for by Prevratil. However, GHC could not find supporting documentation for \$57,503.94 of the claimed items. GHC reviewed expense reports and other available documentation reflecting meals and entertainment of \$12,998.10, lodging of \$9,229.45, transportation of \$7,636.70, parking and other of \$1,975.06 and additional airfare/travel

for an August 2003 trip of \$19,157.24 for travel by Prevratil and "T. Montgomery." GHC believes that many of the "reimbursements" were for items that may be personal in nature or were excessive. For example, the supporting documentation was inadequate to determine the business purpose of the August 2003 extended trip with varied world-wide destinations that included (the list may not be complete): Munich, Germany; Prague, Czech Republic; Jakarta-Soekarno, Indonesia; Denpasar-Bali, Indonesia; and Hong Kong, People's Republic of China. Such payments may be recoverable from Prevratil; however, additional discovery may be needed to determine the nature of the expenses.

- **Life Insurance for Prevratil.** QSDI and RMS made at least \$325,000 of premium payments for life insurance for Prevratil. Documentation indicates that quarterly payments of \$12,500 were required by the life insurance company. Associated with the life insurance premium payments, GHC also located one page of a multi-page agreement that may have been between Prevratil and QSDI that states "The Company will, at its cost, provide the Manager with... term life insurance of \$250,000." GHC believes that term life insurance coverage of \$250,000 should have been available at far less than the premium payments made. More likely and based on the large amount of the quarterly premium payments, GHC believes that the payments may be for a whole life policy and that a significant cash value exists to which QSDI and RMS may have a claim.
- **Transfers from RMS to LHI/Prevratil re: Notes Payable.** Similar to the "preferences" by QSDI described above, RMS made more than \$2.9 million of payments related to two notes payable by RMS to LHI and Prevratil. GHC analyzed the payments made by RMS on the notes and believes that if RMS was in bankruptcy or otherwise subject to liquidation, \$346,508 of the payments is potentially subject to recovery from Prevratil and/or LHI as preferential payments. Under certain circumstances, if additional discovery proves actual or constructive fraud relative to the transfers, the entire \$2.9 million may be recoverable.
- **Payments made to Weissmann Wolff for Bandero Litigation.** QSDI and RMS paid the law firm of Weissmann Wolff et al ("Weissmann") more than \$1.8 million. Such payments were in addition to any payments made to the law firm by others on behalf of QSDI and RMS, including insurers of QSDI and RMS. Much of Weissmann's work appears to be in connection with the Bandero litigation. In the underlying Bandero transactions, QSDI received \$1 million and Prevratil and Paul Leevan ("Leevan") personally received \$5 million. Given the relative amounts received by QSDI, Prevratil and Leevan from Bandero in the original transactions, GHC believes that Prevratil and Leevan may bear personal responsibility for some of the costs of the Bandero litigation. Therefore, based on the amounts paid to Weissmann, the amount recoverable from Prevratil and Leevan for their share of the litigation costs could be more than \$1,250,000.

- **RMS Obligations Paid for by QSDI.** GHC identified a \$25,850 payment made by QSDI for RMS monthly management fees and auto allowance to Prevratil. GHC believes that the payment should have been made by RMS. As such and pursuant to applicable law, the payment may be recoverable from either Prevratil or RMS.
- **Payment for Harvard Tuition.** RMS reimbursed Prevratil \$15,750 for “Tuition Harvard Business” perhaps for one of Prevratil’s sons, Robert Prevratil. GHC could not identify a business purpose associated with the payment. GHC also did not locate any evidence that the payment was reported as taxable compensation to Prevratil or his son. Therefore, the payment appears to be for a personal obligation and might be recoverable from Prevratil. Additional discovery may be necessary to determine whether the expenditure had a business purpose for RMS.
- **Duplicate Loan Fee Reimbursement.** RMS erroneously paid Prevratil \$38,787 too much for expenses and fees related to a \$2.2 million loan that Prevratil took out on his Laguna Beach condo to pay the IRS. Internal documentation authored by Prevratil indicates that the RMS Board agreed to pay the expenses associated with the \$2.2 million dollar loan. GHC believes that the obligation to the IRS related to unpaid payroll tax obligations of RMS and/or QSDI for which Prevratil and/or Bell may have been personally responsible if not paid by one or both of the entities. GHC located evidence that Prevratil was reimbursed, not once but twice. GHC did not find evidence that Prevratil returned the erroneous overpayment. GHC did not find evidence that the duplicate payment was reported as compensation taxable to Prevratil. The duplicate payment should be recoverable from Prevratil.
- **QSDI Obligation Paid for by RMS.** GHC identified a \$20,000 payment made by RMS for the monthly management fee owed by QSDI to Prevratil. GHC believes that the payment should have been made by QSDI. As such, the payment may be recoverable from either Prevratil or QSDI.
- **Major Auto Collision Repairs.** RMS reimbursed Prevratil for automobile repairs totaling in excess of \$11,000. GHC believes that in addition to a \$1,000 per month auto allowance, RMS or QSDI provided Prevratil’s auto insurance. Therefore, GHC is uncertain why major accident repairs were charged to RMS and not covered by insurance.
- **Reimbursements Claimed by Bell.** From 2000 to 2007 and in addition to payments totaling more than \$1.8 million for salary, bonus payments and his estimated share of payments related to the Hawaii condo, GHC identified additional payments made by QSDI and RMS to Bell totaling \$144,145.18 for claimed expense reimbursements. The \$144,145.18 includes auto allowance of \$27,000, auto insurance of \$4,851.12, meals and entertainment of \$11,234.95, lodging of \$4,720.78, transportation of \$5,948.09, supplies

and equipment of \$35,507.28, medical insurance of \$2,428.17 and other items totaling \$6,426.41. Supporting documentation was not sufficient to determine the category for \$33,534.82 of the reimbursements. GHC also identified reimbursements of \$3,801.80 for travel to Hawaii ostensibly including both Bell and his wife. Bell also claimed reimbursement of \$100 for an “electric deposit on Condo.” Further, Bell received reimbursements totaling \$8,591.74 for travel, performance incentives and other items related to Ms. Daphne Aiau, an employee of QSDI. GHC believes that although additional discovery is needed, certain items for which Bell received reimbursement appear to be personal in nature and may be recoverable from Bell.

- **“Accounts Receivable” Transactions.** GHC’s review of the detailed general ledger entries identified one additional potential category of RMS transactions involving charges to Prevratil and Bell accounted for through certain accounts receivable accounts. Such transactions may represent charges to Prevratil for items, meals or services onboard Queen Mary that appear to later be simply reversed through accounting entries. For Prevratil, the accounting entries from 2002 to 2004 total approximately \$30,000 per year. For Bell, such transactions averaged approximately \$3,300 per year. Further investigation is required to determine the nature of the transactions. We have not completed a preliminary analysis for 2005 - 2007, pending further instruction.
- **Overall Compensation May Be Excessive.** The items listed above are in addition to possible general contentions that Bell's and Prevratil's compensation was excessive. GHC calculates that, on average, from 2000 to 2007, Prevratil/LHI received compensation of approximately \$34,000 per month as follows:

Prevratil/LHI	QSDI	RMS	Total
Compensation reported on W-2	\$0	\$23,000	\$23,000
Directors Fee (Estimated)	0	68,000	68,000
Management Fee and Auto Allowance	961,000	1,924,550	2,885,550
Advance on Deferred Compensation	0	55,000	55,000
Unidentified Payments	0	195,895	195,895
Total	\$961,000	\$2,266,445	\$3,227,445

On average from 2000 to 2006, our analyses demonstrate that Bell received more than \$20,000 per month in wages, bonus and other unidentified payments as follows:

Bell	QSDI	RMS	Total
Compensation reported on W-2	\$933,475	\$447,294	\$1,380,769
Bonus	184,500	168,500	353,000
Unidentified Payments	3,762	5,883	9,645
Total	\$1,121,737	\$621,677	\$1,743,414

- **Payments to Individuals and Entities Related to Prevratil.** GHC noted compensation reported on RMS W-2's to individuals believed to be Prevratil's children including Robert Prevratil (\$872,534.51 from 2000 to 2006), Eric Prevratil (\$545,185.21 from 2000 to 2006), and Renee Prevratil (\$9,375 in 2003). Shipwreck Productions, which may involve both Joseph and Eric Prevratil, received payments totaling \$80,753.82.

## SUMMARY OF DETAILED GHC ANALYSES

Additional details regarding the transactions identified above in the Executive Summary – Findings section are provided below. Section A provides information regarding transactions with LHI and Prevratil. Section B provides information regarding transactions with Bell. Section C outlines other potential additional items for which more work is needed.

### A. **LHI/Prevratil**

#### 1. **QSDI - Hawaii condo transactions.**

GHC located evidence that Bell and Prevratil purchased a condo in Hawaii using QSDI funds. Such transfers (or the condo believed to currently be worth more than \$1,000,000) may be recoverable as fraudulent transfers. Items A1a through A1g provide a summary of QSDI payments and accounting entries related to the condo including: the initial purchase, mortgage, utility, condo fee and other payments.

- a. **Initial Purchase Transactions totaling \$121,973.49.** The initial purchase of the condo was funded by QSDI in several transactions totaling \$121,973.49 as follows (presented in chronological date order):
  - i) **September 27, 2002 payment of \$5,000.** Using general account check #003555, QSDI paid \$5,000 to "Title Guaranty c/o Howard Bell." The check is signed by Prevratil and is endorsed to a Title Guarantee Escrow account at the Bank of Hawaii. Per journal entries in QSDI's general ledger, the \$5,000 was ultimately expensed: \$2,500 to Acct. #6541 "General Expense" and \$2,500 to Acct. #6571 "Professional Fees."
  - ii) **October 10, 2002 wire transfer of \$5,000.** Per the bank statement, QSDI paid "Title Guaranty" another \$5,000 through a wire transfer from the General Account. Per journal entries in QSDI's general ledger, the \$5,000 was expensed to Acct. #6541 "General Expense."
  - iii) **December 11, 2002 wire transfer of \$111,973.49.** Per the bank statement, a wire transfer in the amount of \$111,973.49 from QSDI's Waterfront Development

Account was made to "Guaranty Escrow." GHC located a memorandum dated December 10, 2002 from Prevratil to Louise Chick of International City Bank authorizing the wire transfer from the QSDI Waterfront Development account to an account of Title Guaranty Escrow Services, Inc re: "Escrow #A2-105-1215." GHC also located a January 15, 2003 memorandum, subject "Wire transfer 12/10/02" from Bell to Dee Carver (an employee working in the QSDI accounting department) regarding how to record the wire transfer on the books of QSDI. Bell instructed Ms. Carver to expense the wire transfer as follows: Acct. #6541 "General Expense" - \$50,000, Acct. #6571 "Professional Fees" - \$50,000, and Acct. #6989 "Miscellaneous Expense" - \$11,973.49. GHC's analysis of QSDI's general ledger detail confirms that the amounts were recorded as directed by Bell. Bell's memorandum also states: "These amounts represent cost allocations to Joseph Prevratil and Howard Bell for a joint investment." Bell's memo indicates that it was copied to Prevratil.

- iv) All payments identified above were expensed on QSDI's books, rather than recorded as an asset of QSDI or a receivable from Bell and Prevratil. (Also see A1g, below.) No statement regarding the precise joint ownership of the condo as between Bell and Prevratil was located by GHC. However, GHC notes that the accounting entries regarding the initial condo purchase payments were generally split into two equal parts which may indicate equal ownership by Bell and Prevratil.
- b. **Mortgage payments totaling \$73,971.32.** GHC located cancelled checks, mortgage loan statements and other evidence that QSDI made 24 monthly payments totaling \$73,971.32 beginning January 31, 2003, coinciding with the date of the purchase of the Hawaii condo. The last payment made by QSDI was dated December 14, 2004, just before the bankruptcy of QSDI. The cancelled checks evidence payments made to American Savings in Honolulu, Hawaii. The entries in QSDI's detailed general ledger for Acct. #6541 "General Expense," contain a reference number that indicates the American Savings mortgage account #20152400. The payments and general ledger entries correspond to various American Savings Bank mortgage loan statements. The mortgage statements are addressed to "Howard Andrew Bell" and "Joseph Frank Prevratil" re: a property address of "2161 Kalia Road Apt 712 Honolulu HI 96815" and state the principal balance, the escrow amount, the amount paid year-to-date, payment due, the interest rate, etc. The mortgage statements and QSDI check request forms contain handwriting that indicates that Bell authorized the payments to American Savings Bank. For example, the mortgage loan statement dated February 4, 2003 that relates to QSDI check #3613 indicates a principal balance of \$419,581.88 and a payment due of \$2,996.62. The amount is circled with a line connecting a handwritten notation stating: "OK" with Bell's signature and an

additional notation stating “QSDI – G & A Genl Exp.” All payments to American Savings were “expensed” on QSDI’s books rather than recorded as an asset or a receivable from Bell and Prevratil.

- c. **Utility payments totaling \$1,805.15.** GHC’s analysis identified cancelled checks and general ledger detailed entries evidencing 21 (roughly monthly) payments totaling \$1,805.15 to HECO (Hawaiian Electric Company) beginning March 3, 2003 and ending December 31, 2004. Per the QSDI general ledger detail, such payments were expensed to Acct. #6451 “General Expense.”
- d. **Condo fee and other entries totaling \$4,778.67.** Beginning on January 31, 2003 and continuing through July 3, 2003, QSDI’s general ledger indicates one payment of \$309.00 to Hawaiiana Management and six payments of \$309.00 totaling \$1,854.00 to Waikiki Shore. The payments, totaling \$2,163.00 are believed to be condo fees and were expensed through QSDI general ledger Acct. #6540 “Legal.” In addition, per GHC’s analysis of the QSDI general ledger detail for Acct. #6541 “General Expense,” GHC notes a \$99.00 payment to “The Hawaiian” believed to be for insurance and a \$225.00 payment to “Housemaster” that could be for cleaning/maintenance related to the condo. Among the detailed accounting entries recorded in QSDI general ledger Acct. #6541 “General Expense,” most of which relate to the condo, are eleven (debit or expense) items (ten in the amount of \$208.33 and one in the amount of \$208.37) totaling \$2,291.67 denoted as “Amort US Bank Trust Fees.” The eleven items are journal entries that appear to be amortizing U.S. Bank Trust fees. We did not locate actual individual cash disbursements to U.S. Bank in the approximate amounts of \$208. Our analysis did not determine if this “amortization” was related to the condo. However, because the entries were recorded in the QSDI general ledger Acct. #6541 “General Expense” with the other items related to the condo, we include them herein.
- e. **Bell expense check of \$6,619.07.** On February 22, 2005, QSDI paid Bell \$6,619.07 using QSDI General Account check #004708. GHC believes that the transaction is related to the Hawaii condo because the \$6,619.07 amount equals the sum total of the last four offsetting accounting entries from Waikiki Shore Resort described in Item A1f, below. As further described below, the offsetting entries indicate possible receipt of rental income. The general ledger journal entries related to the \$6,619.27 initially record a payable to and a corresponding receivable from Bell on February 22, 2005 and reference an expense report for 2005. The payable is eliminated by payment of check #004708 to Bell. Then, on March 31, 2005, an accounting entry “reclasses” (i.e., reduces) the receivable from Bell to General Expense – Acct. #6541. The entries appear to indicate that the last four amounts that may have been received from Waikiki Shore Resort (individual items in the respective amounts of: \$807.41;



\$1,087.01; \$2,281.78; and \$2,442.87) were paid over to Bell, just prior to the QSDI bankruptcy.

f. **Offsetting Entries from Waikiki Shore Resort and others totaling \$57,814.31.**

Per a review of the detailed entries, the amounts expensed through QSDI general ledger Acct.#6541 "General Expense" for mortgage, utilities, condo fees etc. (see Items A1b, A1c, and A1d, above, totaling \$87,174.21) were partially offset by accounting entries totaling \$57,814.31 indicating possible receipts from the following: one entry denoted as "Bell/Prevratil" in the amount of \$138.08; one entry denoted as "Larry Kee" in the amount of \$1,000; and sixteen entries denoted as "Waikiki Shore Resort" totaling \$56,676.23. The entries denoted as "Waikiki Shore Resort" could possibly indicate rental income received by QSDI. Per discussion in Item A1e above, GHC believes that an amount equal to the last four recorded entries from "Waikiki Shore Resort" was paid to Bell.

g. **1099 or W-2s or repayments by Bell or LHI/Prevratil could not be located.** The Hawaii condo was not listed on QSDI's bankruptcy Schedule A – Real Property or in the Statement of Financial Affairs, submitted by Prevratil in the bankruptcy proceeding, indicating that even though QSDI paid for the condo and related expenses, Prevratil did not consider the condo as an asset of QSDI. Also, the bankruptcy Schedule B – Personal Property did not list a receivable due from Bell or Prevratil. GHC is aware that the Long Beach Press Telegram reported that Prevratil claims the Hawaii condo purchase was part of a bonus program for Bell and Prevratil. However, GHC analyzed W-2's issued to Bell and Prevratil and accounted for the amounts indicated on the W-2's through salary and/or other compensation (i.e., not condo related items). Further, GHC is informed by former QSDI accounting personnel that QSDI did not issue any 1099's to Bell or Prevratil. Therefore, the amounts paid by QSDI related to the condo on behalf of Prevratil and Bell may not have been reported to the IRS as compensation.

2. **QSDI - preference payments re: monies lent by LHI/Prevratil totaling \$387,000 net of "new value" defense.**

LHI/Prevratil claim eight transfers made to or on behalf of QSDI totaling \$1,096,000. They also claimed that they were repaid through nine transfers made by QSDI to LHI totaling \$1,047,000. GHC compiled available supporting documents evidencing the transfers between the parties and researched and analyzed the transactions as further described below.

a. **Amounts received by QSDI from LHI/JFP.** GHC reviewed the transfers to QSDI and noted the following:

- i) GHC confirmed receipts by QSDI of four of the eight receipts from LHI/Prevratil by comparing endorsements on the cancelled checks with QSDI bank statements agreeing the amounts and relative dates. GHC also reviewed corresponding entries made to QSDI's detailed general ledger. The four items thus confirmed totaled \$575,000.
- ii) One of the claimed transfers in the amount of \$100,000 was not received by QSDI but per the endorsement on the check was actually deposited to a bank account of RMS.
- iii) Cancelled checks were not available for the remaining three of the eight items that Prevratil claimed were transferred to QSDI. GHC addressed these items in the following manner:
  - (1) One \$85,000 item was deemed confirmed by reviewing a QSDI bank statement deposit line item with an amount and date as claimed by Prevratil and identifying a corresponding detailed line item in the general ledger that evidenced a deposit in the same amount on a reasonably close date.
  - (2) The second of the three items, in the amount of \$186,000, was deemed confirmed by comparing and agreeing the claimed item amounts and dates to QSDI's internal batch listing and general ledger detail (agreeing amounts and noting dates within one day of the date claimed). GHC also located a related promissory note with a similar date and amount, signed by Howard Bell as Senior Vice President of Finance & Development for QSDI.
  - (3) GHC could not verify the receipt by QSDI of the remaining item in the amount of \$150,000 using a cancelled check or a bank statement because Prevratil noted that: "In June of 2004, JFP paid Weissman, Wolfe, Evall for legal costs incurred by QSDI." Therefore, the item was not paid directly to QSDI. No evidence of actual payment by Prevratil to Weissmann, Wolff, Evall ("WWE") was presented or could be located. However, QSDI's detailed general ledger records, through "ADJ 943" on July 14, 2004, a note payable to Prevratil in the amount of \$150,000. GHC located a memorandum dated July 14, 2004 from Bell to Maria Covarrubias (QSDI accounts payable clerk) with the subject: "Loan – Joseph F. Prevratil" that states:

"In June 2004, Mr. Prevratil paid \$150,000 to the law firm of Weissman, Wolff & Evall on behalf of QSDI. Please reduce the current accounts payable balance by \$150,000 and credit Account #1300-2762000 for that amount. This will increase the loan payable to Mr. Prevratil and reduce the payables liability."

Prevratil and Vernon Matsushita were copied on the memorandum. GHC believes that there is an issue as to whether the legal fees were “incurred by QSDI” or if, in fact, they may have been the responsibility of Prevratil, personally. See further discussion in Item A5, below.

- b. **Amounts paid by QSDI to LHI/JFP.** GHC reviewed transfers by QSDI to LHI/Prevratil as identified by Prevratil and compared the dates and amounts of the listed items to cancelled checks, bank statements and available general ledger listings. GHC confirmed transfers totaling \$1,047,000.
- c. **New value exception.** GHC performed an analysis of potential preferences for the amounts paid to LHI/Prevratil including consideration for potential “new value” provided by LHI and Prevratil to QSDI. For purposes of this analysis, GHC considered all amounts claimed paid by LHI/Prevratil, whether or not confirmed as described in Items A2a above, giving the benefit of any doubt to Prevratil. GHC’s analysis did not take into account other types of payments made to LHI and/or Prevratil by QSDI (e.g., consulting fees, expense reimbursements, etc.) After giving credit for potential new value, GHC’s analysis calculates that a potential cumulative preference of \$387,000 remains.

Thus, per our review of QSDI payments totaling \$1,047,000 to LHI/Prevratil (\$962,000 to LHI and \$85,000 to Prevratil) and after taking into account potential new value exceptions, \$387,000 of payments made by QSDI to LHI/Prevratil are potentially subject to preference recovery from Prevratil by the bankruptcy estate of QSDI.

3. **QSDI - fraudulent transfers re: various personal expenses of Prevratil paid for by QSDI, including extensive travel, meals and entertainment.**

From 2000 to 2003, QSDI made payments to Prevratil for reimbursement of claimed business expenses totaling \$28,050.25 including: meals and entertainment of \$7,347.29, lodging of \$6,387.82, transportation of \$5,940.20 and other of \$1,067.54. An additional \$7,307.40 of payments was made for which no supporting documentation is available for review. Some expenditures seem excessive. However, additional discovery may be needed to determine the nature of the expenditures.

4. **QSDI - fraudulent transfers re: IDS life insurance payments (quarterly payments of \$12,500 were made to insure Prevratil) to extent that any cash value exists.**

From 2000 to 2003, QSDI made payments totaling \$137,500 for life insurance to the IDS Life Insurance Company. (Similarly, RMS also made \$12,500 payments from 2002 to 2007 totaling \$187,500 – see Item A8, below). GHC reviewed the entries in the general ledger detail, cancelled checks, various notices from the insurance company and check

requests authorized by Prevratil. A handwritten note dated October 8, 2000 addressed to “H. Bell” and bearing the initials “JP” states: “We need to pay this – I cannot let it lapse – couldn’t handle the physical again” All such documentation indicates that the life insurance was for Joseph Frank Prevratil. GHC received, pursuant to our request for any agreements between QSDI and Prevratil, and reviewed an unsigned management agreement as of September 1, 2003 and did not note any mention of an agreement for QSDI to pay for life insurance. Further, GHC could not locate a copy of the life insurance policy or other documentation indicating the terms of the life insurance policy and whether QSDI was a beneficiary to the policy. However, given the amount of the premiums, potentially a cash value exists to which QSDI may have a claim.

**5. QSDI - fraudulent transfers re: Weissmann Wolff fees and QSDI insurance coverage payments for Prevratil's (and Leevan's) personal portion of the Bandero litigation.**

GHC is informed and believes that the insurers of QSDI paid portions of Weissmann Wolff legal fees and that much of Weissmann Wolff services are related to the Bandero litigation. In addition to QSDI's insurance coverage payments to Weissmann Wolff, QSDI paid Weissmann Wolff more than \$1.5 million in legal fees believed to be related, in part, to the Bandero transactions. In the original Bandero transactions, QSDI received \$1 million and Prevratil and Leevan personally received \$5 million. Given the relative amounts received by QSDI, Prevratil and Leevan in the original Bandero transactions, GHC believes that Prevratil and Leevan may bear personal responsibility for some of the costs of the litigation with Bandero. Therefore, based on the amount paid by QSDI to Weissmann Wolff, the potential fraudulent transfer to Prevratil and Leevan could be more than \$1,250,000 (or  $\frac{5}{6} \times \$1.5$  million).

As noted in Item A2a(iii)(3) above, Prevratil claims to have paid \$150,000 to Weissmann Wolff directly for QSDI and then had QSDI record a payable to Prevratil. GHC does not know of other amounts paid to Weissmann Wolff by insurers of QSDI, Prevratil or Leevan or if Prevratil (or Leevan) paid Weissmann Wolff directly. Additional discovery is needed to determine what amounts paid by QSDI to Weissmann Wolff might be recoverable as a fraudulent transfer for the benefit of Prevratil (and Leevan).

**6. QSDI - fraudulent transfer re: Management fee and auto allowance totaling \$25,850 paid to Prevratil by QSDI for RMS. GHC believes that this amount should have been paid by RMS, not QSDI.**

Pursuant to an “Interoffice Memorandum” authored by Bell confirming “Director’s fees and Management Fees for fiscal year 2001 – 2002, as approved by their respective Boards,” LHI (on behalf of Prevratil) was to receive \$20,000 per month from QSDI for management fees. (Note that a nearly identical memorandum exists for 2003 – 2004.) The

memorandum indicates that Prevratil, as a member of the RMS Board of Directors was to receive payroll of \$1,000 per month. Further, RMS was to pay LHI a management fee of \$25,000 per month and an auto allowance of \$850 per month. Our review of the books and records of QSDI evidence that from 2000 to 2004, QSDI paid 48 monthly payments of \$20,000 for management fees to LHI totaling \$960,000. On 01/24/2003, QSDI made a \$25,850 payment to LHI that appears to be the monthly management fee of \$25,000 and auto allowance of \$850 due from RMS. GHC believes that the amounts should have been paid by RMS. Therefore, a potential fraudulent transfer exists in the amount of \$25,850.

**7. RMS - fraudulent transfers re: various personal expenses of Prevratil paid for by RMS including extensive travel, meals and entertainment.**

From 2000 to 2007, RMS reimbursed Prevratil for various expenses totaling \$80,450.24 as follows:

- a. Based on a review of expense reports totaling \$11,096.46, from 2000 to 2003, RMS made payments to Prevratil for reimbursement of claimed business expenses including: meals and entertainment of \$5,650.81, lodging of \$2,841.63, transportation of \$1,696.50, parking of \$143.75 and other of \$763.77.
- b. In 2001, 2003 and 2007 additional payments totaling \$50,196.54 were made to Prevratil for which no documentation is available for review.
- c. Further, based on a review of check requests for Prevratil, RMS made a September 17, 2003 payment using check # 099804 in the amount of \$12,975.48 to reimburse travel charges to Prevratil's American Express account by United Airlines "tickets by mail" for Prevratil and Mr. Travis Montgomery. The check request approved by Prevratil indicates "Business Trip, Purchased 8/13/03."
- d. Using check # 100008 dated October 8, 2003, RMS made an additional payment of \$6,181.76 to reimburse Prevratil for more travel charges to his American Express account. The American Express statement indicates travel for Prevratil and T. Montgomery and lists various airlines and destinations, including Munich Germany, Prague Czechoslovakia, Jakarta-Soekarno, Denpasar Bali Indo, and Hong Kong.

Such expenditures appear to be excessive. However, additional discovery may be needed to determine the nature of the expenditures.

**8. RMS - fraudulent transfers re: IDS life insurance payments (quarterly payments of \$12,500 were made to insure Prevratil) to extent that any cash value exists.**

RMS made \$12,500 payments from 2002 to 2007 totaling \$187,500. As mentioned in Item 4 above, from 2000 to 2003, QSDI also made payments totaling \$137,500 for life insurance to the IDS Life Insurance Company. GHC reviewed the entries in the general ledger detail, cancelled checks, and various notices from the insurance company and such documentation indicates that the life insurance was for Joseph Frank Prevratil. GHC could not locate a copy of the life insurance policy or other documentation indicating the terms of the life insurance and whether RMS was a beneficiary to the policy. However, given the amount of the premiums, potentially a cash value exists to which RMS may have a claim.

**9. RMS - preference payments re: monies lent by LHI/Prevratil to RMS or allegedly paid on RMS's behalf by Prevratil totaling \$346,508 net of "new value" defense based on certain assumptions - see attachments.**

GHC compiled a potential preference analysis including consideration for new value. The analysis assumes that new value offsets could apply given that RMS entered into a "General Assignment for the benefit of its creditors" (an "ABC") on January 14, 2008. The analysis is based on two notes payable. One of the notes payable is dated December 31, 2006 in the amount of \$1,296,124.92 payable to LHI. The other note payable is dated July 10, 2006 in the amount of \$1,731,136.00 payable to Prevratil. GHC compiled available supporting documents evidencing the transfers between the parties and researched and analyzed the transactions as further described below.

**a. 12/31/2006 Note payable between RMS and LHI in the amount of \$1,296,124.92.**

The transactions related to this note are recorded in the RMS general ledger Acct.#213400. Our analysis did not take into account other types of payments made by RMS to LHI and/or Prevratil such as consulting fees, expense reimbursements, etc. With respect to transactions related to the December 31, 2006 note, GHC notes the following:

- i) To complete the analysis, GHC assumed that the credit amounts in the note payable account represent cash receipts from LHI/Prevratil. However, GHC notes that the general ledger entries are journal entries. GHC has not received evidence (e.g., a copy of cancelled checks from LHI or Prevratil) of actual cash deposits to RMS bank accounts. Also for purposes of this analysis and new value, certain general ledger entries have been considered as cash receipts even though they are only accounting adjustments. If these amounts do not represent actual receipts,

then new value has been overstated and the cumulative potential preference amount is understated.

- ii) Based on the assumptions noted above and the data from the detailed general ledger of RMS, GHC reviewed payments made by RMS to LHI from December 31, 2004 to November 1, 2007 totaling \$4,277,187.08. Of those payments, GHC considered potential preferences of \$420,000 that were paid within the one-year period prior to the ABC.
  - iii) GHC considered the "receipts" from LHI/Prevratil as noted in the detailed general ledger transactions totaling \$5,565,312 (\$255,000 of which were made within the one-year period prior to the ABC) and applied such receipts as new value.
  - iv) New value exception. GHC performed an analysis of potential preferences for the amounts paid to LHI. After giving credit for potential new value, GHC's analysis calculates that a potential cumulative preference of \$125,000 remains.
- b. **07/10/2006 Note payable between RMS and Prevratil in the amount of \$1,731,136.00.** The transactions related to this note are recorded in the RMS general ledger Acct.#213700. Our analysis did not take into account other types of payments made by RMS to LHI and/or Prevratil such as consulting fees, expense reimbursements, etc. With respect to transactions related to the July 10, 2006 note, GHC notes the following:
- i) To complete the analysis, GHC assumed that the credit amounts in the note payable account represent cash receipts from Prevratil. However, GHC notes that the general ledger entries are journal entries. GHC has not received evidence (e.g., a copy of cancelled checks from Prevratil) of actual cash deposits to RMS bank accounts. Also for purposes of this analysis and new value, a certain general ledger entry has been considered a cash receipts even though it is only an accounting adjustment. If this amount does not represent an actual receipt, then new value has been overstated and the cumulative potential preference amount is understated.
  - ii) Based on the assumptions noted above and the data from the detailed general ledger of RMS, GHC reviewed payments made by RMS to LHI from July 21, 2006 to October 2, 2007 totaling \$527,232.54. Of such payments, GHC considered potential preferences of \$246,120 that were paid within the one-year period prior to the ABC.

- iii) GHC considered the “receipts” from Prevratil as noted in the detailed general ledger transactions totaling \$1,947,713.67 (\$24,612 of which was within the one-year period prior to the ABC) and applied such receipts as new value.
- iv) New value exception. GHC performed an analysis of potential preferences for the amounts paid to LHI. After giving credit for potential new value, GHC’s analysis calculates that a potential cumulative preference of \$221,508 remains.

Thus, per our review of RMS payments relating to the two notes payable and after taking into account potential new value exceptions, a combined \$346,508 of payments made by RMS to LHI/Prevratil are potentially subject to preference recovery from Prevratil by RMS.

**10. RMS - fraudulent transfers re: Weissmann Wolff fees and insurance payments for Prevratil's (and Leevan's) personal portion of the Bandero litigation.**

In addition to QSDI's insurance coverage payments and direct payments to Weissmann Wolff, RMS paid Weissmann Wolff more than \$300,000 in legal fees that could be related to the Bandero transactions in which QSDI received \$1 million and Prevratil and Leevan personally received \$5 million. Therefore, the fraudulent transfer could be more than \$300,000 because RMS did not benefit from the Bandero transaction.

**11. RMS - fraudulent transfer re: payment of Harvard Business tuition totaling \$15,750.**

RMS check voucher copy #085399 dated July 7, 2000 in the amount of \$15,750 was made payable to Prevratil and stated the reason as “Tuition Harvard Business.” The related check request form was signed by Joseph Prevratil and indicated that the check was to be returned to “Robert.” Requisition Number #24079 indicated deliver to “Robert Prevratil” and a description of “Tuition HBS.” As such, the disbursement appears to be personal in nature and therefore might be recoverable as a fraudulent transfer. Additional discovery may be necessary to determine whether the expenditure had a business purpose.

**12. RMS - fraudulent transfer re: duplicate reimbursement of loan fees totaling \$38,797.**

Prevratil was basically reimbursed twice for expenses and fees related to a loan that he took out on his Laguna Beach condo to pay the IRS. GHC is informed and believes that the payments to the IRS related to payroll tax obligations of RMS and/or QSDI for which Prevratil and Bell may have been personally responsible if not paid by RMS and/or QSDI.



- a. **1<sup>st</sup> Payment.** Check #11540 dated July 13, 2006 was issued to Prevratil in the amount of \$38,797.00. GHC reviewed copies of the cancelled check, a RMS check request form prepared on July 12, 2006 and an interoffice memorandum from Prevratil to Bell dated July 10, 2006. The memorandum listed the subject as “New loan to pay off the IRS (RMS)” and stated: “As you know, I took a large loan (\$2.2 million) out on my condo in Laguna Beach so the IRS could be paid. The RMS Board agreed to pay the expenses connected with the loan as well as the monthly difference between my payment of the \$417,000 vs. the \$2.2 million. Attached is the back-up for the \$37,797 in expenses and the escrow statement as back-up and the \$1,000 I paid for the appraisal via my Visa card. Please send me the check this week.” The memorandum appears to bear the signature of Prevratil. The cancelled check indicates that check #11540 cleared the bank on July 17, 2006.
  - b. **2<sup>nd</sup> Payment.** Check #12861 dated October 20, 2006 was issued to Prevratil in the amount of \$38,787 and cleared the bank on October 23, 2006. A RMS check request form dated October 20, 2006 and approved by Bell did not specify a reason for the payment. An email from Daphne Aiau to Maria Cavarrubias dated October 20, 2006 stated “Please do this check for Joseph F. Prevratil \$38,787” and attached the same July 10, 2006 memo from Prevratil to Bell as outlined above. GHC notes that the amount of the 2<sup>nd</sup> check is \$10 less than the 1<sup>st</sup> check. GHC believes that this was a typographical error by Ms. Aiau.
  - c. GHC notes that there is some documentation regarding an accounting adjustment for the 1<sup>st</sup> check #11540 that indicates that the “information posted twice.” However there is no mention of the apparent duplication caused by the issuance of check #12861. GHC notes that both checks cleared the bank. GHC did not find evidence of a repayment by Prevratil to compensate for the duplicate reimbursement.
13. **RMS - fraudulent transfer re: Management fee totaling \$20,000 paid to Prevratil by RMS for QSDI.**

RMS issued check #097394 dated January 24, 2003 to LHI in the amount of \$20,000. The supporting documentation indicates that this was a payment of monthly management fees due from QSDI. GHC believes that this amount should have been paid by QSDI, not RMS.

**14. RMS - fraudulent transfer re: auto repairs totaling more than \$11,000 and monthly reimbursement for an automobile of \$9,000.**

GHC identified reimbursements to Prevratil for automobile repairs totaling in excess of \$11,000. One of the check requests for a reimbursement for automobile repairs cited that the reimbursement was "pursuant to RMS Management agreement" and attached a copy of one page of the agreement. In section 4.4 the last sentence reads "Additionally the Company will provide the Manager with an automobile allowance in the amount of \$1,000 per month, plus the cost of reasonable and customary insurance for such vehicle and all maintenance and repairs of the same. GHC believes that QSDI and/or RMS paid for auto insurance for Prevratil and GHC is therefore uncertain why major accident repairs were charged to RMS. In addition, GHC noted nine RMS payments of \$1,000 each to LHI with no supporting documentation that are likely to be the monthly \$1,000 automobile allowance.

**15. RMS – additional category of transactions for which information is needed**

There is one additional potential category of RMS transactions for which additional information is needed if you want us to pursue it further. The transactions referenced are charges to Prevratil accounted for through the accounts receivable accounts – "AR - City Ledger" and "AR – Clearing" accounts estimated from 2002 to 2004 at \$30,000 per year. We have not completed an analysis for 2005 - 2007, pending your instruction to do so. Such transactions may include charges to Prevratil for items, meals or services on Queen Mary that appear to be simply reversed through accounting entries.

**16. Average Monthly Compensation of approximately \$34,000 per month**

The items listed above are in addition to possible general contentions that Prevratil's compensation was excessive. Prevratil's W-2's reported \$23,000 in compensation and GHC estimates an additional \$68,000 in Director's fees from RMS. LHI received management fees of \$961,000 from QSDI. LHI received an additional \$2,175,000 in management fees, advances on deferred compensation and other unidentified payments from RMS. GHC calculates that, on average, from 2000 to 2007, LHI/Prevratil received compensation of approximately \$34,000 per month.

**17. Payments to Individuals and Entities Related to Prevratil**

GHC noted compensation reported on RMS W-2's to individuals believed to be Prevratil's children including Robert Prevratil (\$872,534.51 from 2000 to 2006), Eric Prevratil (\$545,185.21 from 2000 to 2006), and Renee Prevratil (\$9,375 in 2003). Shipwreck Productions, which may involve both Joseph and Eric Prevratil, received payments totaling \$80,753.82.

**B. Bell**

**1. QSDI - fraudulent transfers re: Hawaii condo transactions - worth Bell's portion of the value of the condo (the condo is believed to be worth in excess of \$1 million).**

See the explanation above in Section A1 related to Prevratil the evidences that QSDI paid for the initial purchase of the condo and made mortgage, utility, condo fee, etc. The same information applies to Bell. Documentation reviewed by GHC indicated a "joint investment" by Bell and Prevratil. Bell's name appears on the mortgage statements. The payments made regarding the initial purchase of the condo were generally split into two equal pieces. Therefore GHC believes that Bell may have owned 50% of the condo. Additional discovery may be required to determine the ownership of the condo. However, it appears that most condo related expenditures were paid for by QSDI.

**2. QSDI - fraudulent transfers re: various personal expenses of Bell paid for by QSDI, including travel for Bell and his wife, meals, entertainment and items for Daphne Aiau.**

From 2000 to 2007 and in addition to salary of \$933,475.40, bonus payments of \$184,500 and approximately \$75,000 of payments related to the Hawaii condo (representing 50% of the net amounts paid by QSDI related to the condo assuming Bell owns 50% of the condo), GHC identified additional payments made by QSDI to Bell totaling \$61,653.48 pursuant to expense reports. The \$61,653.48 includes auto allowance of \$10,200, reimbursement for auto insurance of \$2,901.12, meals and entertainment of \$1,687.41, lodging of \$943.30, transportation of \$2,736.77, supplies and equipment of \$5,921.61, medical insurance of \$2,428.17 and other items totaling \$235.60. Supporting documentation was not sufficient to determine the category for \$31,945.90 of the reimbursements. GHC also identified that Bell was reimbursed for \$2,553.60 of travel to Hawaii including at least one occasion where both Bell and his wife traveled to an "HOA meeting" (believed to be "home owners association" meeting for the condo). In addition, Bell was reimbursed \$100 for the "electric deposit on Condo."

Included in the transportation reimbursement of \$2,736.77 were charges for travel to Puerto Rico for Ms. Daphne Aiau (an employee of QSDI) and "Mr. Lucky Relator" totaling \$1,295.56 on 01/24/2003. Included in the Supplies and Equipment reimbursement of \$5,921.61 were charges for a VCR, \$4,848.74 for "plasma TV for Seawalk," and \$301.68 for a "monitor for D. Aiau."

GHC believes that although additional discovery is needed, certain of the items for which reimbursement was sought appear personal in nature and may be recoverable.

**3. RMS - fraudulent transfers re: various personal expenses of Bell paid for by RMS including travel for Bell and his wife, meals, entertainment and items for Daphne Aiau.**

From 2000 to 2007 and in addition to salary of \$447,293.70 and bonus payments of \$168,500, GHC identified additional payments made by QSDI to Bell totaling \$82,491.68 pursuant to expense reports. The \$82,491.68 includes auto allowance of \$16,800, reimbursement for auto insurance of \$1,950.00, meals and entertainment of \$9,547.54, lodging of \$3,777.48, transportation of \$4,506.88, supplies and equipment of \$29,887.35 and other items totaling \$6,190.81. Supporting documentation was not sufficient to determine the category for \$1,588.92 of the reimbursements. GHC also identified that Bell was reimbursed for \$1,248.20 of travel to Hawaii including Bell, Bell's wife and Prevratil.

Bell was also reimbursed \$6,994.50 for various items related to "D. Aiau" an employee of QSDI including the following: 03/11/2005 "All Way Cruising – D. Aiau" in the amount of \$1,504.05; 08/25/2005 "Performance Incentive – Aiau" in the amount \$1,500.00; 09/12/2005 "Performance Incentive – Aiau" in the amount of \$1,500.00; 02/20/2006 "Carnival Cruise Tax Only – Hyde, Aiau – employee incentive" in the amount of \$223.42; and a 12/07/2006 "Happy Vacation Trip – Aiau" in the amount of \$2,267.03.

GHC believes that although additional discovery is needed, certain of the reimbursements appear personal in nature and may be recoverable.

4. Similar to the Prevratil "AR City Ledger" and "AR Clearing" transactions noted in a paragraph above, Bell also had accounts receivable transactions. Bell's accounts receivable transactions averaged approximately \$3,300 per year. Such transactions may include charges to Bell for items or services on Queen Mary that were simply reversed through accounting entries.
5. The items listed above are in addition to possible general contentions that Bell's compensation was excessive. Bell received nearly \$1.2 million from QSDI for salary, bonus payments and his estimated share of payments related to the Hawaii condo and more than \$600,000 from RMS in salary and bonus. On average from 2000 to 2006, our analyses demonstrate that Bell received more than \$20,000 per month in wages, bonus and other payments.

**C. Potential Additional Items**

There are three additional items that we believe warrant further investigation and/or disclosure as follows:

1. **Transactions with Fullerton bank** - numerous payments were made to a Culman trust through a Fullerton bank. Further investigation is needed regarding these transactions.
2. **Transactions with Brian Jacobs** - two payments, totaling exactly \$9,999.99 were made to an attorney - Brian Jacobs. The payments were originally recorded as a receivable from Prevratil. Later the related entries were reclassified to legal fees. The payments could represent a settlement of a personal matter for Prevratil.
3. **Tax reporting deficiencies** - GHC reviewed all W-2's produced. GHC is informed and believes that no 1099's were issued by QSDI and RMS. Based on our analyses involving the amounts paid to Bell, LHI and Prevratil, GHC believes that there could be significant amounts that may be taxable to Bell and Prevratil and were not properly reported to the taxing authorities.

Our investigation and preliminary conclusions, as of March 21, 2008, are limited by the records made available for our review and the constraints of time in which we had to conduct the review. Therefore, additional investigation and discovery may be needed for the transactions identified. More investigation could be done pending further specific requests and instruction from you.

Let me know if you have any questions or need additional work related to the potential avoidance actions.

Sincerely,



David W. Roberts, CPA, CIRA, CFE  
Partner

Dwr/#373250

cc: David K. Gottlieb (via email – dgottlieb@horwathcal.com)